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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

MARINE BANK
Petitioner

v.

SAMUEL WEAVER and ALICE WEAVER
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR PETITIONER

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PETITION FOR CERTIORARI FILED MARCH 13, 1981
CERTIORARI GRANTED JUNE 1, 1981

QUESTIONS PRESENTED FOR REVIEW

1. Is an FDIC-insured certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, a "security" as defined in the Securities Act of 1933, the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5.

2. Unknown to the lending bank, as consideration for acting as guarantors on a business loan, an agreement was signed between the primary obligors and the guarantors giving the guarantors:

(a) the right to use the barn and pasture of the business;
(b) the right to receive 50% of the "adjusted net profits" of the business so long as they remained co-obligors;
(c) the right to receive $100 per month until repayment of the loan; and
(d) the right to veto any future loans to the business; thereby raising the question whether this agreement is a "security" as defined in the Securities Act of 1933, the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5 and, if a security, whether the bank can be held liable.

PARTIES

The caption of the case contains the names of all parties to the proceeding before the United States Court of Appeals for the Third Circuit.

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(a) THE RIGHT TO USE THE BARN AND PASTURE OF THE BUSINESS;

(b) THE RIGHT TO RECEIVE 50% OF THE "ADJUSTED NET PROFITS" OF THE BUSINESS SO LONG AS THEY REMAINED CO-OBLIGORS;

(c) THE RIGHT TO RECEIVE $100 PER MONTH UNTIL REPAYMENT OF THE LOAN; AND
(d) THE RIGHT TO VETO ANY FUTURE LOANS TO THE BUSINESS; THE AGREEMENT IS NOT A "SECURITY" AS DEFINED IN THE SECURITIES ACT OF 1933, THE SECURITIES EXCHANGE ACT OF 1934 AND THE SECURITIES AND EXCHANGE COMMISSION'S RULE 10b-5 AND, IF A SECURITY, THE BANK CANNOT BE HELD LIABLE.....21

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REPORTS

The opinion of the United States Court of Appeals for the Third Circuit is reported at *Weaver v. Marine Bank*, 637 F.2d 157 (3rd Cir. 1980). It is reproduced in the Petition for Certiorari at pages A-1 through A-23.

The judgment of the United States Court of Appeals for the Third Circuit is reproduced in the Petition for Certiorari at page A-43.

The orders of the United States Court of Appeals for the Third Circuit denying the petition for rehearing before the original panel and for rehearing in banc is reproduced in the Petition for Certiorari at pages A-44 and A-45, respectively.

The memorandum and order of the United States District Court for the Western District of Pennsylvania granting defendant's Motion for Summary Judgment has not been printed in any official reports. It is reproduced in the Petition for Certiorari at pages A-25 through A-41.

JURISDICTION

The jurisdiction of this Court is invoked under the provisions of 28 U.S.C. § 1254(1). The petition for writ of certiorari was filed March 13, 1981, within ninety days of the orders of the Third Circuit denying the petition for rehearing before the original panel and before the court in banc, entered January 26, 1981, as required by 28 U.S.C. § 2101 (c) and Supreme Court Rule 20.

STATUTES AND REGULATIONS INVOLVED

Securities Act of 1933, 15 U.S.C. § 77b (1):

> (1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or sub-

scription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Securities Act of 1933, 15 U.S.C. § 77q(a):

§ 77q. Fraudulent interstate transactions

(A) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Securities Exchange Act of 1934, 15 U.S.C. 78c(a) (10):

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the

foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Securities Exchange Act of 1934, 15 U.S.C.§ 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means of instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. 240.10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

This case is a suit brought by the guarantors of a commercial loan, Samuel and Alice Weaver, against Marine Bank, the lender. The loan was made on March 17, 1978, in the principal amount of $65,000 to Columbus Packing Company, a proprietorship consisting of a wholesale slaughterhouse and retail meat store owned by Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo. (J.A. 32-37).

Some time prior to the loan closing on March 17, 1978, Raymond and Barbara Piccirillo and the Weavers had entered into an agreement which provided that as consideration for Weavers acting as co-obligors on the loan. Weavers were given the following rights:

1) to use the barn and pasture on the slaughterhouse premises;
2) to receive 50% of the "adjusted net profits" of Columbus Packing so long as Weavers remained as co-obligors;
3) to receive $100 per month until the loan was repaid; and
4) to veto any future loans to Columbus Packing. (J.A. 11-12; J.A. 62).

The bank was never informed of this agreement or its contents. (J.A. 20-38; J.A. 62-63; J.A. 64).

On March 17, 1978, the bank loaned Raymond and Barbara Piccirillo, doing business as Columbus Packing, the sum of $65,000. A $65,000 demand note was signed by Raymond A. Piccirillo, Jr. and Barbara J. Piccirillo d/b/a/ Columbus Packing Company and was co-signed by Raymond A. Piccirillo and Mary T. Piccirillo. (J.A. 32-37). Samuel and Alice Weaver executed an agreement of guaranty which guaranteed payment of the principal debtors to a maximum of $50,000. (J.A. 26-29). Collateral for the loan included the pledge by Samuel and Alice Weaver of a $50,000 certificate of deposit issued by Marine Bank. (J.A. 30-31; J.A. 24-25). This certificate of deposit, bearing a due date of February, 1984, had been previously purchased by the Weavers on February 28, 1978 at the Corry, Pa. branch of Marine Bank, not for the purpose of using it in the Piccirillo transaction, but rather for the purpose of having money nearby for the operation of their livestock auction which they operated in that area. (J.A. 44, par. 3 and 4; J.A. 62). Columbus Packing filed bankruptcy on July 21, 1978. (J.A. 7, par. 16).

The Weavers filed a complaint, the basis for federal jurisdiction being an alleged violation of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b). (J.A. 4-12). The document alleged to be a security in the complaint was the "Piccirillo agreement" set forth above. (J.A. 5, par. 7; J.A. 11-12). The bank filed a motion for summary judgment. (J.A. 19). In their answer to the bank's motion for summary judgment, the Weavers alleged that there was an issue of fact as to whether the bank violated the "1934 Securities and Exchange Act and Section 17(a) of the 1933 Securities and Exchange Act" (error in original) and also raised the issue that the certificate of deposit was a security. (J.A. 39). The district court dismissed the action for lack of jurisdiction, holding that no purchase or sale of a security was involved. (Pet. for certiorari, A.25 - A.41).

After summary judgment was granted, the Weavers filed a motion to amend the complaint to include an allegation regarding the 1933 Securities Act and regarding the certificate of deposit. The motion was denied. (Pet. for certiorari, A.42).

The Weavers did not appeal the district court's order denying the motion to amend the complaint, but did appeal the grant of summary judgment.

A three-judge panel of the court of appeals, with one judge dissenting, reversed, holding that both the certificate of deposit and the agreement constituted "securities" under both the 1933 and 1934 Acts. (Pet. for certiorari, A.1 - A.23). A petition for rehearing was denied by the same three-judge panel, and a petition for rehearing in banc was denied by a majority of the circuit judges with two dissents. (Pet. for certiorari, A.44-A.45).

SUMMARY OF ARGUMENT

I. An FDIC-insured certificate of deposit, bearing a fixed rate of interest and issued by a commercial bank, is not a "security" as defined in the Securities Act of 1933, the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b-5. The language of the statutes does not refer to certificates of deposits issued in exchange for currency. A certificate of deposit does not meet the test for an investment contract under the 1933 Securities Act as set forth in *SEC v. W. J. Howey Co.* and as extended to the 1934 Securities Exchange Act in *Tcherepnin v. Knight*, which test requires "a common enterprise with profits to come solely from the efforts of others" because it is payable in dollars at a fixed date at a fixed rate of interest regardless of the bank's profitability.

Three federal courts of appeals and numerous district courts have concluded that bank certificates of deposit do not constitute investment contracts under either Act.

The certificate of deposit is not a "note" as contained in the definition of a security simply because it matures in more than nine months. The transaction is commercial, not investment, in nature.

The legislative history of the Securities Acts infers that Congress did not intend bank certificates of deposit to be included as "securities." The contemporaneous passage of the Glass-Steagall Banking Act and the Federal Deposit Insurance Act mitigates against extension of the Securities Acts to such documents. To treat a certificate of deposit as a security will superimpose on existing federal and state regulatory schemes a second pattern of regulations by the Securities and Exchange Commission, and will extend federal court jurisdiction to routine banking transactions in which an instrument constituting evidence of interest payable is issued in return for a currency deposit.

II. The "Piccirillo Agreement" does not constitute an "investment contract" or a "profit-sharing agreement" under the *Howey* and *Tcherepnin* tests for a security because it does not include multiple investors, there is no pooling of funds, the success of the business arrangement is not totally dependent upon the skills of the business

owner (Piccirillo), and there was no advertisement or public offering. It was rather a tailor-made contract between two local men engaged in the cattle business, with personal benefits for both.

Even if the Piccirillo agreement were a "security", the bank cannot be held liable under SEC Rule 10b-5 because the bank did not know the agreement existed. Therefore, the alleged misstatements of the bank were not "in connection with" the agreement. The bank must have knowledge of the illegal scheme at the time it loaned the money and knowingly render substantital assistance to the scheme to be held liable under 10b-5. While the legality of the alleged bank conduct may be determined under many federal and state statutes or common law, Rule 10b-5 should not be extended so as to make banks the insurers of the actions of their debtors in the course of routine commercial transactions.

ARGUMENT

I. AN FDIC-INSURED CERTIFICATE OF DEPOSIT, BEARING A FIXED RATE OF INTEREST AND ISSUED BY A COMMERCIAL BANK IS NOT A "SECURITY" AS DEFINED IN THE SECURITIES ACT OF 1933, THE SECURITIES EXCHANGE ACT OF 1934 AND THE SECURITIES AND EXCHANGE COMMISSION'S RULE 10b-5.

The Weavers have alleged a violation of the antifraud provisions of the Securities Exchange Act of 1934, 48 Stat. 891, 15 U.S.C. § 78j(b) and the Securities and Exchange Commission's Rule 10b-5, 17 C.F.R. § 240.10b-5. The Weavers have also attempted to allege a violation of the Securities Act of 1933, 48 Stat. 74, 15 U.S.C. § 77q(a).[1] These sections generally prohibit engaging in fraud in connection with the

1. The complaint filed in this case did not allege a violation of the Securities Act of 1933, 15 U.S.C. § 77q(a), nor did it allege that the pledge of the certificate of deposit was a "security." It alleged only a violation of the Securities Exchange Act of 1934, 15 U.S.C. § 17j(b), based upon the "Piccirillo Agreement." (J.A. 4-12). In the Weaver's answer to the bank's motion for summary judgment, the Weavers alleged that there was an issue of fact as to whether the bank violated the "1934 Securities and Exchange Act and Section 17(a) of the 1933 Securities and Exchange Act [sic]" and also raised for the first time the issue of the certificate of deposit as a security. (J.A. 39). The opinion of the district court discussed both statutes. (Pet. for Cert. A.25-A.41). After summary judgment was granted, the Weavers filed a motion to amend the complaint to include an allegation regarding the 1933 Securities Act and regarding the certificate of deposit. This motion was denied by the district court on the ground that under F.R.C.P. 56, all theories of liability advanced by the Weavers had "been considered and will be before the Court of Appeals." (Pet. for Cert. A.42). The Weavers did not appeal from the district court's order denying the motion to amend the complaint, but briefed the issue of the 1933 Securities Act and the certificate of deposit before the Third Circuit. The Third Circuit's opinion, which squarely decided the certificate of deposit issue, appears to be based on the Securities and Exchange Act of 1934. (Pet. for Cert. A.2-A.14). However, the Third Circuit noted in a footnote that the Weavers had alleged a 1933 Act violation in the motion to file an amended complaint, and in a subsequent footnote stated that the definition of a security in the 1934 Act "as is here relevant... is essentially the same as in §2(1) of the Securities Act of 1933...". (Pet. for Cert. A.2, n.1; A.5, n.2). The Third Circuit did not properly have the issue of the 1933 Securities Act or the issue of the certificate of deposit as a "security" before it, there having been no appeal from the district court's denial of the motion to amend the complaint. However, because of the Third Circuit's apparent decision that (1) the certificate of deposit is a security and (2) it is a security for purposes of *both* Acts, the bank presented both questions for review. (Pet. for Cert. i).

purchase or sale of a security. It is the position of the Marine Bank that the bank "certificate of deposit" is not a "security" as defined in that Act.

A copy of the instrument was not incorporated into the Weaver's complaint, but the essential terms and characteristics of the certificate of deposit appear in the record.

In return for a deposit of $50,000 by the Weavers on February 28, 1978, the certificate of deposit was issued by the Corry branch of the Marine Bank, an FDIC insured banking institution, in the amount of $50,000. (J.A. 41; J.A. 44). It is a six year certificate of deposit, due in February of 1984, and bearing the fixed rate of interest payable at that time. (J.A. 41; J.A. 24; J.A. 30; J.A. 58). The certificate of deposit was purchased by the Weavers for the purpose of having money nearby for the operation of their livestock auction which they operated in that area. (J.A. 41).[2] On March 17, 1978, the Weavers acted as guarantors of a loan by Marine Bank to Raymond A. and Barbara J. Piccirillo, d/b/a Columbus Packing Company. The note evidencing the loan was in the amount of $65,000 and was co-signed by Raymond A. and Mary T. Piccirillo, Sr., the parents of Raymond. The Weavers, as guarantors, signed a guaranty agreement limited to the amount of $50,000. As collateral for the guaranty agreement, the Weavers pledged and assigned the $50,000 Marine Bank certificate of deposit.

To determine whether the Securities Acts apply to the pledge of this bank certificate of deposit, the starting point is the language of the statute itself. *International Brotherhood of Teamsters v. Daniel,* 439 U.S. 551 at 558 (1979). The definition of "security" does not specifically list certificates representing currency deposits, but refers only to a

2. In the recitation of facts contained in the opinion of the Third Circuit, the impression is given that the certificate was both purchased and pledged to secure the Piccirillo loan on March 17, 1978. (Pet. for Cert. A.3). This is incorrect. As stated in the affidavits submitted by the Weavers in response to the bank's motion for summary judgment, the certificate was purchased on February 28, 1978, so that the Weavers would have a deposit close to the livestock auction they had purchased in October of 1977. (J.A. 41; J.A. 62.). The Weavers contend that at that time they "had no investment interests whatsoever in the business known as the Columbus Packing." (J.A. 41, par. 4). They did not pledge the certificate to Marine Bank as collateral for the Piccirillo loan until March 17, 1978, at which time the Weavers contend the certificate assumed the characteristics of a "security" under the Securities Acts. (J.A. 39).

"certificate of deposit, for a security."[3] This language refers to instruments issued by security holders' protective committees in the course of corporate reorganizations and has been construed not to include a certificate of deposit issued in exchange for currency. *Canadian Imperial Bank of Commerce v. Fingland*, 615 F.2d 465 (7th Cir. 1980); *Burrus, Cootes and Burrus v. MacKethan*, 537 F.2d 1262 at 1264, *withdrawn as moot*, 545 F.2d 1388 (4th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977); *Superintendent of Insurance of State of New York v. Banker's Life & Casualty Co.*, 300 F. Supp. 1083 at 1099 (S.D.N.Y. 1969), *aff'd* 430 F.2d 355 (2d Cir. 1970), *rev'd on other grounds*, 404 U.S. 6 (1971); *SEC v. Fifth Avenue Coach Lines, Inc.*, 289 F. Supp. 3 at 31 (S.D.N.Y. 1968), *aff'd on other grounds*, 435F.2d 510 (2d Cir. 1970); H.R. Report No. 85, 73rd Cong., 1st Session, 1933, Section III 2. Section 3(a) (10), in referring to a "certificate of deposit, for a security," can further be construed to imply the negative; that is, a certificate of deposit issued for currency is excluded. *Burrus*, 537 F.2d at 1265.[4] The omission of any reference to pension plans in the definition of "security" was considered significant by this Court in *Daniel* where it stated:

> In spite of the substantial use of employee pension plans at the time they were enacted, neither § 2(1) of the Securities Act nor § 3(a) (10) of the Securities Exchange Act, which defines the term "security" in considerable detail and with numerous

3. The 1933 Act refers to "certificate of deposit for a security" without the comma. However, the definition of security in Section 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1) is virtually identical and the coverage of the two acts is considered the same. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 847 n. 12 (1975); *Tcherepnin v. Knight*, 389 U.S. 332, 342 (1967). As noted in *Tcherepnin*, the definition of security in the 1934 Act was intended to be "substantially the same as [that contained] in the Securities Act of 1933." S. Rep. No. 792, 73d Cong., 2d Sess., 14 (1934). The major difference between § 10(b) of the 1934 Act and § 17(a) of the 1933 Act is that while an implied cause of action exists under § 10(b), this Court has never decided whether a private cause of action exists under § 17(a) of the 1933 Act. *Aaron v. SEC*, 446 U.S. 680 at 689 (1980).

4. The Proposed Official Draft of the Federal Securities Code of the American Law Institute specifically excludes from the definition of "security" . . . "A bank certificate of deposit that ranks on a parity with an interest in a deposit account with the banks." The Proposed Official Draft of the Federal Securities Code, dated March 15, 1978.

examples, refers to pension plans of any type. *International Brotherhood of Teamsters v. Daniel,* 459 U.S. 551 at 558 (1979).

This theory is equally applicable to time certificates of deposit which, like pension plans, were commonly used and known to the legislators who framed the acts.[5]

The Third Circuit in this case looked to other sections of the definition, but was ambiguous as to whether it based its opinion on the "any note" phrase in the definition or whether it viewed the certificate as an "investment contract." Noting that the Marine Bank certificate had a due date in excess of nine months, the majority opinion concluded that the certificate of deposit is "the functional equivalent of any other corporation's bond or note." (Pet. for Cert. A.12). Yet the majority relied almost exclusively upon this Court's decision in *Tcherepnin v. Knight,* 389 U.S. 332 (1967), which dealt with the phrase "investment contract". (Pet. for Cert. A.11). The key to the Third Circuit's inexactness is found in its faulty premise that the definition of a security ought to be interpreted with "a presumption of coverage of any transaction which Congress did not expressly exclude." (Pet. for Cert. A.13). This premise conflicts with this Court's decision in *International Brotherhood of Teamsters v. Daniel,* 439 U.S. 551, which analyzed the particular financial relationship to determine whether Congress intended to *include* non-contributory compulsory pension plans, rather than to exclude them. This approach, when applied to a bank certificate of deposit, leads to the conclusion that the 1933 and 1934 securities statutes were not intended to encompass documents which evidence ordinary banking and deposit accounts.

In applying the *Tcherepnin* test for an investment contract as a scheme involving a common enterprise with profits to come solely from the efforts of others, the Third Circuit found the certificate of deposit to be "functionally" the same as the shares involved in *Tcherepnin v. Knight,* 389 U.S. 332 (1967). In so holding, the court ignored critical differences between the two instruments.

5. In contrast to the omission of time certificates of deposit from the definition of "security", the Glass-Steagall Act, passed by the same 73rd Congress, refers in several sections to time certificates of deposit. 12 U.S.C. § 371a; 12 U.S.C. § 264(c) (12); 12 U.S.C. § 264(v) (8).

The bank time certificate of deposit at issue in this case is payable in dollars at a fixed future date of February, 1984. (J.A. 30). In return for the certificate, the Weavers receive interest at a fixed and contracted rate. The Weavers are entitled to receive that sum on that date notwithstanding the "entrepeneurial or managerial efforts" of Marine Bank or its profitability.[6]

A certificate of deposit of this nature contrasts sharply with the withdrawable capital shares in a savings and loan association held in *Tcherepnin* to possess the essential characteristics of an investment contract as that term is used in the Securities Exchange Act of 1934.[7] The withdrawable capital shares in *Tcherepnin* were found to be investment in nature because the holders were automatic members of the association, entitled to vote and not entitled to a fixed rate of return. Rather, under Illinois law, the holders received dividends as declared by the association's board of directors and based on the association's profits. As a result of state law tying dividends to an apportionment of profits, the shareholders in *Tcherepnin* received a return on investment only if the association was profitable due to the skill and honesty of its management. This arrangement is in marked variance with the bank certificate of deposit, which pays a fixed rate of interest not related to the profits to be realized, if any, by the bank from the use of the money and uninfluenced by the managerial skills of the bank. Owners of a bank certificate of deposit are not entitled to vote, they do not own shares in the bank and are not entitled to a voice in the management of the bank. It is closer in nature to a savings account than to the capital stock of the bank.

The Third Circuit's misconstruction of *Tcherepnin* was based upon a false impression. The court reasoned that when this Court decided *Tcherepnin*, it "must have been aware" that the administrator of National Banks had in 1966 endorsed the Securities and Exchange

6. In fact, Marine Bank is prohibited from using the term "profit" in referring to interest paid on a time certificate of deposit. 12 C.F.R. Sec. 329.8(e).

7. The same definition of an investment contract applied in *Tcherepnin* as a common enterprise with profits to come solely from the efforts of a third party has been applied to the phrase "investment contract" in the 1933 Act. *SEC v. Howey*, 328 U.S. 293 (1945).

Commission's view that deposit accounts were securities. (Pet. for Cert. A.11). In fact, the various agencies controlling the banking industry had in 1966 *not* concurred in that position but merely stated it without concurrence in connection with certain advertising policies to be followed by financial institutions. 31 Fed. Reg. 16581-16582 (1966).

Three federal courts of appeals have considered the issue presented here and found that bank certificates of deposit do not constitute "investment contracts." In *Canadian Imperial Bank of Commerce Trust Company v. Fingland,* 615 F.2d 465 (7th Cir. 1980), it was held that a complaint alleging that trust funds were invested in certificates of deposit, issued by a Bahamian bank and bearing a fixed rate of return failed to allege a scheme involving a common enterprise with profits to come from the efforts of others. The Fifth Circuit has held that a certificate of deposit, issued by a commercial U.S. bank, is not an investment contract. *Bellah v. First National Bank of Hereford, Texas,* 495 F.2d 1109 (5th Cir. 1974). A certificate issued to a depositor by the Norfolk Savings and Loan Corp. was found by the Fourth Circuit to be commercial in nature and thus not a "security" under the 1934 Act. *Burrus, Cootes and Burrus v. MacKethan,* 537 F.2d 1262, *withdrawn as moot,* 545 F.2d 1388 (4th Cir. 1976), *cert. denied,* 434 U.S. 826 (1977). Finally, the Ninth Circuit examined an investment package in which a credit union purchased bank certificates of deposit from a broker who offered a 5/8% bonus on maturity. In holding that the financial relationship was a "security", the Court emphasized the nature of the transaction as an "integrated investment package which must be viewed in its entirety", thereby assuming the certificate of deposit alone did not constitute a "security". *Safeway Portland Employees' Federal Credit Union v. C.H. Wagner & Co., Inc.,* 501 F.2d 1120 (9th Cir. 1974).

A considerable number of district courts have also concluded that bank certificates of deposit are not securites as defined in the Securities Acts.[8]

Although discussing only the investment aspect of the Weavers' certificate of deposit, the majority opinion in the instant case also relies in part on the fact that the certificate of deposit does not mature until six years from the date of issuance and that the definition of a security excludes any note "which has a maturity at the time of issuance of not exceeding nine months." Securities Exchange Act of 1934, 15 U.S.C. § 78c(a) (10); Pet. for Cert. A.11. The negative pregnant that the Weaver certificate must be a security because it matured in more than nine months and is the "functional equivalent of any corporation's bond or note," is in error. (Pet. for Cert. A.12). A note payable in less than nine months may be a security, and notes which mature in more than nine months may not be securities. *Bellah v. First National Bank of Hereford, Texas, 495 F.2d at 1111-1112 (5th Cir. 1974); McClure v. First National Bank of Lubbock, Texas,* 497 F.2d 490 at 492-494 (5th

8. In accord: *Ayala v. Jamaica Savings Bank,* CV-80-1802 (E.D. New York, June 15, 1981), CCH Federal Securities Law Reports par. 98041, holding that time certificates of deposit bearing a fixed rate of interest issued by an FDIC insured savings bank and providing no voting rights are not securities under the 1933 or 1934 Acts; *Hamblett v. Board of Savings and Loan Associations of the State of Mississippi,* 472 F. Supp. 158 (N.D. Miss. 1979), holding that "savings certificates" and "savings passbooks" issued by a stock savings and loan association as a result of depositing funds, bearing a fixed rate of interest and no right to vote, not a "security" under the 1934 Act; *Hendrickson v. Buchbinder,* 465 F. Supp. 1250 (S.D. Fla. 1979), holding that passbooks and certificates of deposit issued by a group of Bahamian banks not "securities" within the meaning of the 1934 Act; *State Public School Building Authority v. Mellon Bank, N.A.,* Civil Action No. 76-537 (M.D. Pa. July 3, 1980), holding that certificates of deposit issued by Mellon Bank in return for deposits of the State Public School Building Authority not securities within the meaning of the 1933 and 1934 Acts; *Swank Federal Credit Union v. C.H. Wagner & Co., Inc.,* 405 F. Supp. 385 (D.C. Mass. 1975), *assuming arguendo* that ordinary bank certificates of deposit are not securities.

In an analogous area, certificates of deposit issued by federally regulated banks have been held not to be securities under the Investment Company Act of 1940, 15 U.S.C. Sections 80a-1 *et. seq.,* which contains a definition of a security not significantly different from the Securities Acts. Investment Company Act of 1940, 15 U.S.C. Sec. 80a-2(a)(36); *SEC v. Fifth Avenue Coach Lines, Inc.,* 289 F. Supp. 3, 28, 31 (S.D.N.Y. 1968), *aff'd.* 435 F.2d 510 (2d Cir. 1970); *Drovers Bank of Chicago v. SFC Corp.,* 452 F. Supp. 580, 582 (N.D. Ill. 1978).

Cir. 1974); *Emisco Industries, Inc. v. Pro's, Inc.*, 543 F.2d 38 (7th Cir. 1976); *Lino v. City Investing Company*, 487 F.2d 689 at 693-696 (3rd Cir. 1973); *Great Western Bank & Trust v. Kotz*, 532 F.2d 1252 (9th Cir. 1976); *Zeller v. Bogue Electric Manufacturing Corp.*, 476 F.2d 795 (2nd Cir. 1973). The distinction drawn in these cases, and commonly referred to as the "commercial/investment" dichotomy, hold that notes executed in the context of a commercial—as opposed to investment—transaction are exempt from the Securities Acts.[9]

In *Bellah*, the debtors borrowed money from a bank to aid them in their livestock business, executing a note secured by a mortgage and pledge of a certificate of deposit. The debtors later claimed the bank misrepresented that they need not worry about foreclosure. The Fifth Circuit affirmed dismissal for lack of jurisdiction, stating:

> The record reveals that in extending the loans, the Bank merely intended to aid the [debtor] in the operation of their livestock business. It is bereft of any evidence that the Bank sought to profit from the successful operation of this enterprise . . . We merely hold that notes issued in the context of a commercial loan transaction fall beyond the purview of the [1934] Act. *Bellah v. First National Bank of Hereford, Texas*, 495 F.2d at 1113-1114 (5th Cir. 1974).

Concluding that the note itself was not a security because the transaction was commercial in nature, the court also held that the certificate of deposit likewise was not a security because it was part of the same commercial transaction. *Id.* at 1114-1116.

This commercial/investment distinction is critical to the difference between a certificate of deposit issued by a commercial bank and a debt obligation of a non-banking corporation. Marine Bank is in the business of borrowing and lending money. The interest to be paid the Weavers is fixed and does not depend on the profitability of Marine

9. M. Lipton and G. Katz " 'Notes' Are Not Always Securities", 30 Business Lawyer 763 (1975).

Bank.[10] Rather, Marine has promised to pay the Weavers a set amount of interest by contract. Regardless of the profits, if any, realized by Marine from the use of the Weavers' deposit, the bank is obligated to pay the stated interest. This transaction is a contractual obligation, not an investment.[11]

In addition to the language of the Securities Acts themselves, their legislative history is instructional on the issue of whether Congress intended a bank certificate of deposit to be security. This Court in *International Brotherhood of Teamsters v. Daniel* relied in part upon the legislative history of the Securities Act to conclude that Congress did not intend noncontributory, compulsory pension plans to be under the scope of the Securities Acts. *Daniel*, 439 U.S. at 563-564. Similarly, the legislative history of the 1933 and 1934 Acts infers that Congress did not intend bank certificates of deposit to be included as "securities." Just as ERISA, governing the use and terms of pension plans, undercut

10. While banks are frequently active in an aftermarket of certificate of deposit funds, this is the way in which banks make a profit for themselves, not their depositors. "If this were not the case, banks could not pay anyone interest on their deposits and everyone would be just as well off stuffing their money under their own mattresses...." *State Public School Building Authority v. Mellon Bank, N.A.*, Civil Action No. 76-537 (M.D. Pa. July 3, 1980) [holding that certificates of deposit issued by Mellon Bank in return for deposits of the Pennsylvania State School Building Authority were not securities within the meaning of the 1933 and 1934 Acts].

11. Besides "investment contract" or "note", the only other phrase which might literally apply to the present case is the phrase "evidence of indebtedness", which appears only in the 1933 Act. This Court has rejected a literal approach to the definitional section of the Securities Acts in favor of the economic realities of the transaction. *United Housing Foundation v. Forman*, 421 U.S. 837, 848 [rejecting the argument that "any...stock" included shares of stock issued by a non-profit housing cooperative]; *Tcherepnin v. Knight*, 389 U.S. 332, 336. The "economic reality" of the Weavers' purchase of the certificate was to have a deposit in a bank near their place of business—a commercial purpose. (J.A. 44; J.A. 62). The certificate was not transformed into a "security" when it was later pledged for the Piccirillo loan in an equally commercial context. Even under a literal reading, this phrase has been held not to include deposits in federally regulated banks. *SEC v. Fifth Avenue Coach Lines, Inc.*, 289 F.Supp 3, 28, 31 (S.D.N.Y. 1968); *Drovers Bank v. SFC Corp.*, 452 F.Supp. 580, 582 (N.D. Ill. 1978).

arguments for extending Securities Acts to certain pension plans,[12] so the Glass-Steagall Banking Act of 1933 and the Federal Deposit Insurance Act dealing expressly and in detail with bank certificates of deposits mitigates against extension of the Securities Acts to such documents.

Both the Securities Acts and Glass-Steagall were passed by the 73rd Congress to prevent the recurrence of abuses caused by bank involvement in securities activities which gave impetus to the 1929 stock market crash. The legislative purpose of federal regulation of securities transactions was stated in *Ernst & Ernst v. Hochfelder* as follows:

> The Securities Act of 1933 [cite omitted] was designed to protect investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and . . . to promote ethical standards of honesty and fair dealing [cite omitted]. The 1934 Act was intended principally to protect investors against manipulation of stock prices . . . and to impose regular reporting requirements on companies whose stock is listed on national securities exchanges. [cite omitted].
> *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 at 195 (1976).

The 1933 and 1934 Acts were, therefore, designed to protect investors in "securities" by assuring that those investors were adequately informed in buying and trading *without* guaranteeing the soundness of their investment.[13]

12. "If any further evidence were needed to demonstrate that pension plans . . . are not subject to the Securities Acts, the enactment of ERISA in 1974 would put the matter to rest . . . Congress believed that it was filling a regulatory void when it enacted ERISA, a belief which the SEC actively encouraged. Not only is the extension of the Securities Acts . . . unsupported by the language and history of those Acts, but in light of ERISA, it serves no general purpose." *Daniel*, 439 U.S. at 569-570.

13. "Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn a profit. There is, however, an obligation upon us to insist that every new issue of securities . . . shall be accompanied by full publicity and information . . ." House of Representatives Report No. 85, 73rd Congress, 1st Session, President Roosevelt's Message to Congress on March 29, 1933.

On the other hand, the Glass-Steagall Act, passed contemporaneously with the Securities Acts, was designed in part to *insure* deposits against loss through the creation of the Federal Deposit Insurance Corporation. Obviously distinguishing between investors covered by the Securities Acts and depositors covered by the Glass-Steagall Act, the 73rd Congress designed a system whereby depositors, unlike investors, would be afforded protection against risk of loss. Thus each depositor in an insured bank such as Marine is protected by federal deposit insurance on the aggregate of all deposits in that bank.

To further implement the distinction between investments and deposits, Section 16 of the Glass-Steagall Act prohibits national banks from underwriting securities and dealing in securities for a bank's own account. 12 U.S.C. § 24 (Seventh). The Federal Reserve Act subjects all state member banks to the same restrictions. 12 U.S.C. § 335. In addition, non-member state banks insured by the FDIC are indirectly also subject to this limitation. 12 U.S.C. § 378. This general prohibition against bank underwriting of securities was reinforced by § 21 of the Act, which makes it unlawful for any underwriter of securities to engage in the banking business.[14] This scheme was intended by Congress to sever commercial banking from investment activity for the reason that:

> ... Congress was concerned that commercial banks in general and member banks of the Federal Reserve System in particular had both aggravated and been damaged by stock market decline partly because of their direct and indirect involvement in the trading and ownership of speculative securities.
> *Investment Company Institute v. Camp*, 401 U.S. 617 at 629-630 (1971).

14. "(a) After the expiration of one year after June 16, 1933, it shall be unlawful—
(1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor . . .". 12 U.S.C. § 378(a).

Marine Bank is clearly in the business of accepting deposits. If banks engaged in accepting deposits are prohibited under Glass-Steagall from issuing, selling and underwriting securities, and a certificate of deposit is a "security", the issuing of a certificate of deposit in return for a cash deposit must violate Glass-Steagall. The only way to refute this conclusion would be if a certificate of deposit could be a "security" for purposes of the Securities Acts but not for purposes of Glass-Steagall; that is, to say a "security" under Glass-Steagall is defined more restrictively than under the Securities Acts. Yet a narrow reading of the word "security" under Glass-Steagall was rejected in *Investment Company Institute v. Camp:*

> ... There is nothing in the phrasing of either § 15 or § 21 that suggests a narrow reading of the word "securities." To the contrary, the breadth of the term is implicit in the fact that the antecedent statutory language encompasses not only equity securities but also securities representing debt.
> *Investment Company Institute v. Camp,* 401 U.S. at 635.

To treat a certificate of deposit as a security would superimpose on already existing federal and state banking regulatory schemes a second pattern of regulations by the Securities and Exchange Commission, with attendant risks of inter-agency conflict and of the SEC's want of specialized relevant expertise in this area of banking. *Burrus, Cootes and Burrus v. MacKethan,* 537 F.2d 1262 at 1265.

Insured banks are heavily regulated by rules prescribed by the Federal Deposit Insurance Corporation which provide a panoply of protections for time certificate of deposit owners such as the Weavers. The existence of this separate body of federal law dealing expressly and in detail with bank certificate of deposits undercuts arguments for extension of the Securities Acts to such documents, *International Brotherhood of Teamsters v. Daniel,* 439 U.S. at 569-570. Just as ERISA contains specific disclosure requirements to employees and further controls the substantive terms of pension plans, the Federal Deposit Insurance Act governs disclosures which must be made in connection with bank certificates of deposit and controls their substantive terms. For example, advertisements, announcements, and solicitations relating to interest or dividends paid on "deposits", which include time certificates of deposit, cannot be inaccurate, misleading,

or misrepresent the deposit contract. 12 C.F.R. § 329.1(b), (c); 12 C.F.R. § 329.8(f). The term "profit" may not be used in referring to interest of dividends paid on a time certificate of deposit. 12 C.F.R. § 329.8(e). Advertisements and solicitations relating to interest must be stated in terms of annual rates of simple interest. 12 C.F.R. § 329.8(a). If an advertised rate is payable only on deposits meeting time or amount requirements, the requirements must be clearly and conspicuously stated. 12 C.F.R. § 329.8(d). Interest rates and their computations are regulated, as are penalties on payments before maturity. 12 C.F.R. § 329.3; 12 C.F.R. § 329.6; 12 C.F.R. § 329.4. The FDIC examines its insured banks and may conduct special examinations for insurance purposes. 12 U.S.C. § 1817(a). The FDIC also has the power to order insured state nonmember banks to cease and desist unsafe or unsound banking practices on the violation of any rule or regulation of the agency. 12 U.S.C. § 1818(b) (1). Such practices can result in termination of insured status. 12 U.S.C. § 1818(a). Any bank officer or director engaged in such practices may be suspended or removed from office. 12 U.S.C. § 1818(e). These rules are enforced through a system of district offices, which include branches to handle and coordinate consumer complaints. This scheme of federal regulation provides protection to persons such as the Weavers both through insurance and through a system of controls regarding advertising, disclosures and terms of a certificate of deposit backed by a program of supervision, audits and disciplinary proceedings.

In addition to the FDIC regulations and examinations, Marine Bank is also thoroughly examined periodically by the Pennsylvania Department of Banking, which includes a review of all assets of the bank, all loans and collateral for loans, the conduct of its affairs, investments, the interests of insiders and compliance with the law. This examination is to "safeguard the interests of depositors, other creditors, or shareholders of the institution." Department of Banking Code, Act of May 15, 1933, 71 P.S. § 733-401. To add the regulations of the S.E.C. to these federal and state schemes would impose burdensome and duplicative regulations on an already highly regulated industry.

To affirm the Third Circuit's reasoning that the Securities Acts reach "virtually every transaction in which an investor might expect to receive a return on his money" (Pet. for Cert. A. 12-13), would extend

federal court jurisdiction to other banking transactions in which a bank issues an instrument which constitutes evidence of interest payable because of a currency deposit. In addition to a certificate of deposit, such transactions would include a money market certificate, a small saver certificate, a savings deposit and a negotiable order of withdrawal (NOW account). On the other hand, to exclude bank time certificates of deposit from federal securities law will not leave the Weavers and those similarly situated without redress. In addition to federal and state protective regulations and federal insurance, the Weavers may have a right of action under state law, as they have alleged violations of the Pennsylvania Securities Act of 1972, 70 P.S. § 1-101 *et seq.* (J.A. 8-9). This act, based on the Uniform Securities Act, contains a provision virtually identical to Securities and Exchange Commission Rule 10b-5. 70 P.S. § 1-401. The Weavers may be further protected from alleged bank fraud under Pennsylvania common law, as set forth in their complaint. (J.A. 9).

Rather than interpret the Securities Acts as a source of general federal jurisdiction to afford relief to the certificate of deposit owner who may pledge the certificate as collateral for a loan which goes into default, or who is unhappy with his or her deposit for whatever reason, Marine Bank would urge this Court to hold that an FDIC insured certificate of deposit, issued in exchange for currency by a commercial bank, and bearing a fixed rate of interest is not a "security" as defined in the Securities Act of 1933 and the Securities Exchange Act of 1934.

II. WHEN UNKNOWN TO THE LENDING BANK, AS CONSIDERATION FOR ACTING AS GUARANTORS ON A BUSINESS LOAN, AN AGREEMENT WAS SIGNED BETWEEN THE PRIMARY OBLIGORS AND THE GUARANTORS GIVING THE GUARANTORS:

(a) THE RIGHT TO USE THE BARN AND PASTURE OF THE BUSINESS;

(b) THE RIGHT TO RECEIVE 50% OF THE "ADJUSTED NET PROFITS" OF THE BUSINESS SO LONG AS THEY REMAINED CO-OBLIGORS;

(c) THE RIGHT TO RECEIVE $100 PER MONTH UNTIL REPAYMENT OF THE LOAN; AND

(d) THE RIGHT TO VETO ANY FUTURE LOANS TO THE BUSINESS, THE AGREEMENT IS NOT A

"SECURITY" AS DEFINED IN THE SECURITIES ACT OF 1933, THE SECURITIES EXCHANGE ACT OF 1934 AND THE SECURITIES AND EXCHANGE COMMISSION'S RULE 10b-5 AND, IF A SECURITY, THE BANK CANNOT BE HELD LIABLE.

Unknown to Marine Bank, and as consideration for acting as guarantors on the loan, an agreement was signed between the Piccirillos and the Weavers. This document gave the Weavers:

(a) the right to use the barn and pastures of Piccirillos' business;
(b) the right to receive 50% of the "adjusted net profits" of the business so long as Weavers remained co-obligors on the loan;
(c) the right to receive the sum of $100.00 per month until repayment of the loan; and
(d) the right to veto any future loans to Piccirillo's business. (J.A. 11-12).

The decision by the Third Circuit that this agreement (the "Piccirillo Agreement") constitutes a "security" seriously misapplies the criteria for a security under the 1933 Securities Act as set forth in *SEC v. W. J. Howey Co.*, 328 U.S. 293, 301 (1946) and as extended to the 1934 Securities Exchange Act in *Tcherepnin v. Knight*, 389 U.S. 332 (1967), which test requires "an investment of money in a common enterprise with profits to come solely from the efforts of others." (Pet. for Cert. A. 5-9). This phrase has been the subject of numerous and varying judicial interpretations. However, through the factual context of all these cases run common elements tht include multiple investors, pooled funds, public offerings or advertisements aimed at nonresident and frequently unwitting persons attracted solely by monetary profit and dependent on the management, expertise and control of a promoter. The emphasis placed on each individual factor depends upon the individual Circuit Court and its interpretation of the *Howey* test. Yet under none of the various tests developed by the Circuit Courts can the Piccirillo agreement be deemed to be a security.

Howey involved an offering to some 6,000 tourists and vacationers in the U.S. and Canada of a land sales contract for individual, small citrus groves. Being offered to nonresidents with no experienc e in the citrus business, the buyers were also offered a service contract wherein

the selling company then leased the land and cultivated and marketed the crops as one big citrus grove with a large force of skilled personnel and sophisticated equipment. The buyer had no right to market his crop, all the produce was pooled by the company and profits allocated at the time of picking. Such a scheme was found to be an investment in a common enterprise with profits to come solely from the efforts of the company.

Focusing upon the large number of investors, the common cultivation of all the groves, and pooling of produce, the Seventh Circuit has interpreted the *Howey* test to require both multiple investors and a pooling of funds. *Milnarik v. M-S Commodities, Inc.*, 457 F.2d 274 (7th Cir. 1972). In *Milnarik*, the court found that an investment contract in which the plaintiffs had deposited money with a broker on the understanding that he could use the funds at his discretion to trade commodity futures for the benefit of the plaintiffs was not a "security" because (1) each investor had a separate unitary contract with the broker and (2) each contract was independent of the other since the funds in each were not pooled and the success or failure of one contract was not tied to the fortunes of the other contracts. The requirement of a sharing or pooling of funds was reiterated in *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 (7th Cir. 1977), which rejected the contention that discretionary futures trading accounts were "securities" because the funds in the accounts were not commingled.

The same result regarding discretionary accounts was affirmed by the Third Circuit because the enterprise involved (1) no group of investors and (2) no pooling of funds for a common purpose. *Wasnowic v. Chicago Board of Trade*, 352 F. Supp. 1066, 1069 (M.D. Pa. 1972), *affirmed without opinion*, 491 F.2d 752 (3rd Cir. 1974), *certiorari denied*, 416 U.S. 994.

This pooling of assets among multiple investors, characterized as *horizontal* commonality, has been rejected by the Fifth Circuit and the Ninth Circuit which are aligned in their interpretation of the *Howey* test for a common enterprise as "one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment of third parties." *SEC v. Continental Commodities Corporation*, 497 F.2d 516 at 518 (5th Cir. 1974) quoting *SEC v. Glen W. Turner Enterprises, Inc.*, 474 F.2d 476 at

482 n. 7 (9th Cir.) *certiorari denied,* 414 U.S. 821 (1973). Noting that in *Howey* the inexperienced investors, knowing nothing about the citrus business, depended for their profits on the farming, managerial and marketing skills of the defendant company, the courts applying this test focus on the relationship between the investor and the promoter. Characterized as *vertical* commonality, this test requires that the fortuity of the investment be dependent on the promoter's expertise.

For example, in determining that a seller of commodities futures options who rendered investment counseling as part of an enterprise, the success of which was contingent upon that counseling, sold a "security", the Fifth Circuit focused upon the fact that the success of the investments, both individually and collectively, was dependent upon the promoter's capabilities. *Securities and Exchange Commission v. Continental Commodities Corporation,* 497 F.2d 516 (5th Cir. 1974). Similarly, the Ninth Circuit found an investment scheme when faced with a pyramid franchise which depended for its success on the efforts of promoters who gave the sales pitch and ran the motivational "Dare to be Great" seminars. *SEC v. Glen W. Turner Enterprises,* 474 F.2d 476 (9th Cir.), *cert. denied,* 414 U.S. 82 (1973).

Applying either of the approaches outlined above, the Piccirillo agreement fails to rise to the dignity of a "security." The requirement of multiple investors is lacking, the agreement being only between Raymond and Barbara Piccirillo and Samuel and Alice Weaver. (J.A. 11-12). As noted by Judge Weis in his dissent to this case, property owned by a husband and wife creates, in Pennsylvania, a tenancy by the entireties which means the interest of a husband and wife is considered one estate and each spouse is seized of the whole. Pet. for Cert. A.17, n.1, citing *In re Holmes Estate,* 414 Pa. 403, 406, 200 A.2d 745 (1964); *Nachman v. Nachman,* 417 Pa. 589, 208 A.2d 247 (1965) [registration and placement of securities in names of husband and wife created tenancy by entireties in the securities]. Thus there exists only one "investor"—Mr. and Mrs. Weaver. The requirement of a pooling of assets is lacking, the Weavers having pooled funds with no one. Thirdly, the success of the business arrangement is not totally dependent upon the skills of the Piccirillos, nor is Mr. Weaver a non-resident inexperienced in the cattle business. Not only are the Weavers given absolute veto power over future loans to the business, they are also given a right to use the business barn and pasture, a tangible benefit to

the Weavers who operated a cattle livestock auction in the same locale. (J.A. 11-12, par. 2A, 3). Unlike the investors in *Howey*, who "resided" in distant localities and were totally unfamiliar with the citrus business, the Weavers are cattle dealers in the same small Pennsylvnaia town who sat down face-to-face in a trailer with the Piccirillos' and hammered out an agreement tailor-made to their individual needs.[15] Such an agreement was and is wholly unsuited to accommodate outside third persons, and no public interest is affected by its existence. It stands in sharp contrast with the public offerings and promotions involved in the two seminal cases decided by this Court. *[SEC v. Howey, supra,* involving sales to 42 nonresidents and offers to 6,000 tourists and vacationists; *Tcherepnin v. Knight, supra,* a class action by more than 5,000 investors]. Finally, even if the fortunes of the Weavers may have depended to some degree upon the efforts of Piccirillo, the same is not true for the bank. The bank simply made a collateralized loan and no allegation has been made that the bank was involved in the enterprise.[16]

The fact that the Piccirillo agreement was a tailor-made arrangement between two men engaged in the cattle business, with personal use accommodations made for the Weavers, added to Weavers' control over future loans to the business, the lack of any public interest in the transaction, and the absence of multiple investors, a pooling of assets, a public offering or advertising, all combine to remove the Piccirillo agreement from the boundaries established by this Court for an investment "security."

These same elements combine to remove the Piccirillo agreement from the parameters of a profit-sharing agreement. A profit-sharing agreement requires generally the same elements of mutual risks, public

15. In fact, on the day the agreement was signed, the parties negotiated a change in Weavers' share from 35% to 50%. (J.A. 11; Depo. A. Weaver, Tr. 51; Depo. E.M. Weaver, Tr. 27).

16. The bank had no knowledge the Piccirillo-Weaver agreement existed, as discussed *infra.* Marine expected nothing more than repayment of its loan. This is unlike the enterprise in *Hector v. Wiens,* 533 F.2d 429 (9th Cir. 1976), where the defendant farmer alleged that a feedlot, which fed and old his cattle, had promised the bank that it would seek potential cattle buyers and refer them to the bank for recommendations and financing.

participation, pooling and dependency on promoter expertise. The courts have applied the same econmic tests to profit-sharing agreements as to investment contracts. *Hirk v. Agri-Research Council, Inc.*, 561 F.2d 96 at 102 (7th Cir. 1979) and cases cited therein. Nor should any literal distinctions be made, the courts being guided by the economic realities of the situation; not by the labels employed the parties. *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851-852; *accord, International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551 at 558.

Since the Marine Bank neither purchased nor sold the Piccirillo agreement, it can be liable only if it knew its misstatements would be used in connection with the purchase or sale of the Piccirillo agreement. The court of appeals erred in not requiring any allegation of scienter or knowledge on the part of the bank that its alleged misrepresentations might be or would be used in connection with the agreement.

The bank officers involved could not have known that their alleged misstatements would be used "in connection with" the Piccirillo agreement for the simple reason that the bank did not know the agreement existed.[17] The agreement was, in fact, a secret "side" agreement proposed by Mr. Piccirillo to induce Mr. Weaver to act as a guarantor on his loan. Piccirillo offered Weaver "a little share of the business." (J.A. 62; Depo. E.M. Weaver, Tr. 24-25). The agreement, prepared by Piccirillos' attorney, was taken to the Weaver

17. Judge Gibbons of the Third Circuit at oral argument indicated that whether the bank knew of the agreement was a question of fact for a jury. This cannot be a question of fact when the plaintiffs (1) have not pleaded that the bank knew or should have known of the agreement, (J.A. 4-10); (2) did not deny in their counter-affidavits the sworn statments of the bank officers submitted in conjunction with the summary judgment motion that they had no knowledge of the contract or its contents (J.A. 20-38) and (3) admitted in depositions that they never told the bank about the agreement. (J.A. 62-63; J.A. 64). Since the bank presented through deposition and affidavit evidence that would entitle it to a directed verdict if not controverted at trial, this evidence must be accepted as true on the summary judgment motion. The undisputed statements contained in the bank's affidavits are taken as true. The Weavers' failure to offer counter-affidavits or other evidence to indicate that the bank had knowledge of the agreement resolves the factual determination in favor of the bank. Federal Rule of Civil Procedure 56(e). Jurisdictional issues are for the court, not a jury, to decide, whether they hinge on legal or factual determinations. *Williamson v. Tucker*, 632 F.2d 579 at 588 (5th Cir. 1980).

home where the four of them, after making certain changes, signed it. (J.A. 62; Depo. E.M. Weaver, Tr. 25-29, 31). Although the Weavers kept a signed copy, Mr. Weaver responded to the question "Did you ever tell the Marine Bank about that agreement?" as follows:

> No; they never knew about that agreement, that I know of. I never told them. In fact, I never was to the bank from the time I loaned the money, put the money in the C.D.... (J.A. 62-63).

Identical testimony was offered by Alice Weaver who testified:

Q. - Did you tell Mr. Santom about the agreement with Mr. Piccirillo?
A. Weaver: No.
Q. - Is there any reason why you didn't tell him about it?
A. Weaver: No.
Q. - You had the original of this in your possession, isn't that correct?
A. Weaver: That's right.
Q. - But you didn't bring it with you to show it to the Marine Bank at all?
A. Weaver: No. (J.A. 64).

Futhermore, Robert Santom and John Daggett, the only employees of Marine Bank who had any dealings with the Weavers, both submitted affidavits that they had never seen the contract and had no knowledge of its contents or of *any* interest of the Weavers in the business, oral or written, in addition to their commercial obligations as guarantors of the loan. (J.A. 20-38). These affidavits wer uncontradicted by the Weavers. (J.A. 41-43). The mere failure of the bank to discover the existence of the agreement in the course of a routine commercial transaction cannot be a basis of 10b-5 liability, just as the failure of an accounting firm to discover internal fraudulent practices of a client in the course of a routine, procedurally proper audit cannot sustain an action under 10b-5. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

18. As further inducement to act as co-guarantor, Mr. Piccirillo gave Weaver a $10,000 note against Piccirillo's father's home. "Yes, give me elder Piccirillo's note for ten thousand dollars, that I wouldn't lose any money through loaning him a little capital through the bank." (Depo. E. M. Weaver, Tr. 25).

Since the bank did not know of the agreement, the bank's liability arises only because it failed to discover Mr. Piccirillo's activities in offering the "little share of the business" to Weavers—that is, the bank's liability is secondary liability. In *Ernst & Ernst v. Hochfelder*, this Court upheld a motion for summary judgment where the plaintiffs, victims of a fraudulent securities scheme by a brokerage firm president, failed to allege an intent to deceive on the part of the accounting firm auditing the firm's books, but rather sought to recover on the basis of the accountant's failure to discover the fraud. Rejecting a negligence standard, this Court found an allegation of scienter necessary to state a private cause of action for damages under Rule 10b-5. Scienter was also held to be an element of a civil enforcement action by the Commission. *Aaron v. SEC*, 446 U.S. 680 (1980). The Third Circuit's holding in this case that 10b-5 liability can be predicated upon the bank's negligence in failing to discover the Piccirillo agreement ignores that scienter requirement. It transforms a bank into an insurer of the integrity of its customers, and would impose 10(b) liability on any institution lending money to the market manipulator. The plight of Marine Bank in this situation has been illustrated as follows:

> If all that is required in order to impose liability for aiding and abetting is that illegal activity under the securities laws exists and that a secondary defendant such as a bank, gave aid to that illegal activity, the act of loaning funds to the market manipulator would expose the bank to liability for aiding and abetting. Imposition of such liability upon banks would virtually make them insurers regarding the conduct of insiders to whom they loan money. If it is assumed that an illegal scheme existed and that the bank's loan or other activity provided assistance to that scheme, some remaining distinguishing factor must be found in order to prevent such automatic liability. *The bank's knowledge of the illegal scheme at the time it loaned the money or agreed to loan the money provides that additional factor.* Knowledge of wrongful purpose thus becomes a crucial element . . . Ruder, *Multiple Defendants in Securities Law Fraud Cases*, 120 U. Pa. L. Rev. 597 at 630-631 (1972). (Emphasis added).[19]

19. This concept has also been applied in the criminal law context. This Court has held that to aid and abet a crime, it is necessary that a defendant "in some sort associate himself with the venture, that he participate in it as in something that he wishes to bring about, that he seek by his action to make it succeed." *Nye & Nisson v. United States*, 336 U.S. 613, 619 (1949).

The Fifth Circuit has followed the scienter requirement in a case almost identical to the instant one, holding that in order for a bank to be exposed to 10b-5 liability, a violation of the securities laws must exist, the bank must be generally *aware* of its role in the improper activity, and *knowingly* render substantial assistance.[20] *Woodward v. Metro Bank of Dallas*, 522 F.2d 84 (5th Cir. 1975). In *Woodward*, the plaintiff co-signed a bank note on behalf of a corporation and pledged a certificate of deposit, along with corporate stock as collateral. The corporation subsequently filed bankruptcy proceedings and the plaintiff sued the bank, among others, alleging failure to disclose all its information about the corporation's financial status. Assuming *a fortiori* that the note and pledge of stock was a "security", the court held that in a commercial transaction, the bank must be aware of the improper activity and knowingly assist it. The same standard that the defendant must know of the securities violation and knowingly render substantial assistance has also been adopted in the Second, Sixth and Third Circuits. *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2d Cir. 1978); *SEC v. Coffey*, 493 F.2d 1304 (6th Cir. 1974); *Landy v. Federal Deposit Insurance Corporation*, 486 F.2d 139 (3rd Cir. 1973).

In this case the alleged violator, Marine Bank, was engaged in a customary business activity—that of loaning money. How can the bank protect itself from 10b-5 liability in such a setting? To discover the Piccirillo agreement, the bank would have had to investigate the activities of Mr. Piccirillo and fully inquire into the motives of Mr. Weaver for acting as a guarantor.[21] The bank would have had to

20. This test is the same as that contained in the Restatement of Torts, Sec. 876(b).

21. Parenthetically, inquiry by the bank as to why Weaver was acting as a guarantor did not serve to reveal the Piccirillo agreement. The bank was told the reason for Weavers' interest was the obvious benefit to a cattle auctioneeer in assisting a local meat dealer who had daily contact with cattle farmers.

Daggett: "The only thing that Tony [Piccirillo] ever said, that he would possibly be able to help Sam [Weaver] in his business, that Tony knew a lot of farmers that may be able to help Sam's business, because Tony knows a lot of people who Sam didn't. And Sam's age, Tony would be a much younger man and stuff, that he might be able to help him that way." (J.A. 59).

Santom: "I can recall one particular conversation that I had with Tony [Piccirillo] about this and he implied that his connections with the farmers around the area and so forth was going to assist in increasing the sale of cattle through Sam's [Weaver] auction barn, but that was the extent of any conversation . . .". (J.A. 49).

determine incontrovertibly that the Weavers and Piccirillos has made no "agreement" which might be construed as a "security" and, in addition, ascertain through some undefined method that Piccirillo had perpetrated no fraud on Weaver. Since it would be impossible for any bank employee to assume the non-existence of fraud, a bank would in the alternative have to assume that fraud existed in all accommodation arrangements and automatically interject itself into those arrangements on pain of 10b-5 liability by releasing to the potential co-obligor the entire financial history and credit status of the primary debtor.[22]

This is not to infer that a bank's duty to disclose such information may not arise in some circumstances and under some body of applicable law. The relationship between a bank and its customers is governed by many laws, including others the Uniform Commercial Code, Truth-in-Lending, the Equal Credit Opportunity Act, state banking statutes and common law, any one of which might govern the fact situation presented here.

However, nothing in the statutory language, legislative history of judicial interpretations of the Securities Exchange Act infers that Rule 10b-5 was meant to be extended this far. To expose banks to automatic 10b-5 liability for the acts of its debtors in the course of routine commercial transactions will impose an entire federal scheme on an already highly regulated industry while affording no additional protection to those persons which 10b-5 was designed to protect.

22. This may be confidential information that the customer does not want made public. It will in almost all situations involve a customer not credit-worthy on his or her own, as "the *raison d'etre* of accommodation is to find stronger financial support. . .". *Woodward*, 522 F.2d at 99. The customer may well complain that the bank is interfering with his or her contractual relations.

CONCLUSION

For the foregoing reasons, the order of the district court granting the motion for summary judgment should be affirmed and the action dismissed.

Respectfully submitted,

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